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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY

Before the
Federal Communications Commission
Washington, D.C. 20554

In the Matter of	)	
	)	
Implementation of the Telecommunications Act of 1996:	)	**CC Docket No. 96-150**
	)	
Accounting Safeguards Under the Telecommunications Act of 1996	)	

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COMMENTS OF AT&T

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August 26, 1996

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AT&T generally endorses the Commission's proposals to apply its current accounting rules, with certain modifications, to the provision of services authorized or potentially authorized under Sections 260 and 271 through 276 of the Telecommunications Act of 1996. However, the Commission's proposed accounting rules do not fully address the more important underlying conditions that would give the BOCs an overwhelming ability to harm competition if and when they are permitted to offer such services. Because of the BOCs' current monopolies in local exchange and access markets, the BOCs' access charges are far in excess of their economic cost. As the Commission recognizes (see NPRM, ¶ 15), these charges, if left in place, would permit the BOCs to undertake a classic price squeeze in the interexchange market. Therefore, as long as the BOCs retain their monopoly power, it is critically important that the Commission complete the work of access reform and, in so doing, establish an environment in which all carriers can obtain inputs to telecommunications services at economic cost, i.e., long-run incremental cost.

The accounting safeguards proposed by the Commission are nevertheless useful to the extent they will make it easier to detect -- and therefore deter -- abuses of monopoly power and violations of other Commission policies. The new Act gives the Commission ample authority to adopt such measures: as the Commission tentatively concludes, Section 272 gives the agency

authority to promulgate accounting rules governing all interLATA telecommunications and information services, including intrastate, interLATA services. This reading is compelled by the plain language of the Section 272, which draws distinctions only between interLATA and intraLATA services, rather than between intrastate and interstate services.

AT&T also agrees with the Commission's tentative conclusion that the existing affiliate transaction rules should apply with some modifications to services that BOCs (and all incumbent LECs) offer through separate subsidiaries. First, the BOCs' interLATA affiliates should be required to follow Part 32 USOA accounting procedures, even if the Commission does not deem such affiliates to be dominant carriers (as it should), in order to facilitate proper auditing and monitoring of compliance with the accounting safeguards. Moreover, the BOCs should be required to treat interLATA services as "nonregulated" for purposes of accounting for transactions between the BOC and the affiliate.

In addition, the Commission should amend its affiliate transaction rules to require that carriers value transactions involving services according to the same rules and methods that currently apply to transactions involving assets. Moreover, the Commission should not permit carriers to grant their affiliates "discounts" from the "prevailing company price" based on perceived differences in the amount the carrier must spend on marketing its services to the affiliate. The Commission should also require annual auditing of the BOCs and their affiliates, and should require the BOCs' affiliates to report publicly all financial information on a regular basis just as the BOCs do today in ARMIS.

Finally, the Commission should apply the existing cost allocation rules to services that the BOCs offer on an integrated basis, such as "incidental" and "out-of-region" interLATA services. The Commission must ensure, however, that the BOCs impute the cost of access plus the incremental cost of the non-access portions of the service to its provision of such offerings, and that those costs are properly reflected in the BOCs' end-user rates for such services.

In combination with broader access reform initiatives, these accounting safeguards will help prevent abuses of the BOCs' current monopoly power in local exchange and access. They will be necessary, moreover, only as long as that monopoly power remains in place.

Before the
Federal Communications Commission
Washington, D.C. 20554

In the Matter of **Implementation of the Telecommunications Act of 1996:** **Accounting Safeguards Under the Telecommunications Act of 1996**	**CC Docket No. 96-150**

COMMENTS OF AT&T

Pursuant to Section 1.415 of the Commission's Rules and its Notice of Proposed Rulemaking, FCC 96-309, released July 18, 1996 ("NPRM"), AT&T Corp. ("AT&T") submits these comments on accounting safeguards under the Telecommunications Act of 1996 ("the Act" or "the 1996 Act").

INTRODUCTION

In this NPRM, the Commission has sought comment principally on the extent to which its existing cost allocation and affiliate transaction rules should apply to the BOCs and their separate subsidiaries if and when the BOCs are hereafter authorized to provide interexchange services originating within their regions pursuant to Section 271 of the 1996 Act. The Commission also seeks comment on the extent to which those rules should apply to certain "incidental" and out-of-region interexchange services that the BOCs are currently authorized to provide under the Act either through a separate subsidiary or on an integrated basis. The Commission tentatively concludes that its existing rules, with some modifications, will satisfy its statutory mandate to establish accounting safeguards that will protect competition in these markets that the BOCs seek to enter for the first time.

AT&T largely agrees with the Commission's proposed approach. While such accounting "safeguards" could never truly guard against the BOCs' ability and incentive to misallocate costs and thereby cross-subsidize their operations in competitive markets, many of these accounting rules -- in combination with stringent structural and nondiscrimination safeguards[1] -- can help detect or deter some of the more egregious and blatant forms of cross-subsidization. Indeed, the marginal protections these "accounting safeguards" afford are useful in several contexts. First, they can provide some marginal protection against cross-subsidization for purposes of calculating both the BOCs' sharing obligations and the proper productivity offset under the Commission's price cap regime. Second, the rules would offer some protection for the BOCs' access ratepayers, for interconnectors and new entrants in local markets, as well as for competition in the interexchange, information services, and equipment manufacturing markets in which the BOCs' affiliates would be operating. For these reasons, these rules should be adopted.

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1 <u>See generally</u> AT&T's Comments (filed Aug. 15, 1996) in <u>Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934, as amended; and Regulatory Treatment of LEC Provision of Interexchange Services Originating in the LEC's Local Exchange Area</u>, Notice of Proposed Rulemaking, CC Docket No. 96-149, FCC 96-308 (released July 18, 1996) ("<u>BOC In-Region NPRM</u>").

Nonetheless, none of the rules proposed in this proceeding even seeks to combat the much more important, systemic conditions that give the BOCs an overwhelming ability to act anticompetitively in the interexchange market, should they be granted such authority. The BOCs still control bottleneck facilities for both access services and local exchange services, and the BOCs' access charges far exceed the BOCs' economic costs. As long as this continues, the BOCs will be able to undertake a classic price squeeze in the interexchange market: while nonaffiliated interexchange carriers must absorb a BOC's high access charges as a real cost, the BOC and its long-distance affiliate would not, and therefore the BOC could increase its rivals' costs, underprice them, and thereby harm the competitive process. See NPRM, ¶ 15.

Therefore, although the Commission should adopt the "accounting safeguards" discussed in these Comments, it is critically important that the Commission complete the work of true access reform and allow interexchange carriers to compete on a more even playing field by purchasing access at its economic (i.e., long-run incremental) cost. Indeed, until all inputs into telecommunications services -- including unbundled network elements, exchange access, and universal service subsidies -- are calculated according to such a cost standard, the BOCs will continue to have a virtually limitless capacity to thwart competition in all telecommunications markets, both local and long distance. If and when true competition for local exchange and exchange access services develops, the Commission at that time could consider the removal of these accounting safeguards.

The remainder of these Comments are organized as follows: Section I addresses the scope of the Commission's statutory authority and concludes that the Commission has jurisdiction to establish accounting safeguards relating to both interstate and intrastate interLATA services; Section II discusses the extent to which the affiliate transaction rules should be applied to the BOCs' provision of interLATA services through a separate subsidiary; and Section III examines the extent to which the cost allocation rules should apply to the BOCs' provision of interLATA services on an integrated basis.

I. SECTIONS 271 AND 272 AND THE COMMISSION'S RULES IMPLEMENTING THEM APPLY TO ALL INTERLATA TELECOMMUNICATIONS SERVICES AND INTERLATA INFORMATION SERVICES.

The Commission first seeks comment on whether Sections 271 and 272 grant the agency authority to establish accounting rules for both intrastate and interstate interLATA telecommunications services, and for both intrastate and interstate interLATA information services. See NPRM, ¶¶ 43-50. The Commission's tentative conclusion that it does have such authority is correct.

The Commission's authority under Sections 271 and 272 extends to "interLATA services," which the statute defines as "telecommunications between a point located in a local access and transport area and a point located outside such area." See Section 3(42). Because many states contain more than one LATA, interLATA services can be either intrastate or interstate. Nonetheless, none of the provisions of Sections 271 or 272 recognize any distinction between intrastate and interstate interLATA services; the only geographic boundaries even mentioned in these sections are the LATA boundaries and the relation of the state to a particular BOC's region (i.e., whether the State is in-region or out-of-region). Therefore, as the Commission notes, the interLATA/intraLATA distinction has "supplanted the traditional interstate/intrastate distinction for purposes of these sections."[2]

Moreover, Section 2(b) of the Communications Act does not preclude the Commission from promulgating accounting rules to govern the provision of intrastate interLATA services. As AT&T has explained elsewhere, courts have uniformly held that Section 2(b) does not negate the express regulatory authority granted to the Commission in other provisions of the Act.[3] Sections 271 and 272 grant such express authority, and therefore the Act supersedes Section 2(b) for purposes of these implementing rules.[4]

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2 See NPRM, ¶ 45; see generally AT&T's BOC In-Region NPRM Comments at 7-14.

3 See, e.g., California v. FCC, 39 F.3d 919, 931-33 (9th Cir. 1994), cert. denied, 115 S. Ct. 1427 (1995); PUC of Texas v. FCC, 886 F.2d 1325, 1333-35 (D.C. Cir. 1989); NARUC v. FCC, 746 F.2d 1492, 1498-1501 (D.C. Cir. 1984); see also Louisiana PSC v. FCC, 476 U.S. 355, 375-76 n.4 (1986).

4 See NPRM, ¶ 49; see also Implementation of Local Competition Provisions in the Telecommunications Act of 1996, First Report and Order, CC Docket No. 96-98, FCC 96-325, ¶¶ 83-103 (released Aug. 8, 1996) (adopting similar analysis in the (continued...)

Despite these provisions, however, the States retain an important role. For example, the States will be integrally involved in the auditing process. See Section 272(d). Moreover, States will continue to have the authority to use their own accounting methods for any intrastate services other than those that either have been pre-emptively deregulated by the Commission (such as information services) or for which jurisdiction has been expressly granted to the Commission under the Act (such as intrastate, interLATA telecommunications services).[5]

II. THE COMMISSION SHOULD APPLY THE EXISTING AFFILIATE TRANSACTION RULES, WITH CERTAIN MODIFICATIONS, TO ALL TRANSACTIONS BETWEEN THE BOCS AND THEIR NONREGULATED AFFILIATES.

The Act not only gives the Commission authority to establish accounting rules in this area, but it also specifies certain standards that the BOCs must follow. Section 272(a)(2) of the Act requires the BOCs to offer certain services -- including origination of interLATA telecommunications service (other than incidental, out-of-region, or previously authorized

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(...continued)
context of Section 251).

5 See Separation of Costs of Regulated Telephone Service from Costs of Nonregulated Activities, Report and Order, CC Docket No. 86-111, 2 FCC Rcd. 1298, 1310 (¶¶ 88-93) (1987) ("Joint Cost Order"), recon., 3 FCC Rcd. 6701 (1988), aff'd sub nom. Southwestern Bell Corp. v. FCC, 896 F.2d 1378 (D.C. Cir. 1990). The Commission also has authority, pursuant to Sections 260 and 275(b)(2), to promulgate accounting rules governing the intrastate aspects of telemessaging services and alarm monitoring services provided by any incumbent LEC. Both sections confer broad authority on the Commission to regulate all such services, without any distinctions between interLATA or intraLATA, or between interstate or intrastate.

service) and interLATA information services (other than electronic publishing and alarm monitoring services) -- only through a separate subsidiary. Moreover, Section 274 of the Act independently requires that BOCs provide electronic publishing through either a "separate affiliate" or a joint venture that is to be "operated independently" from the BOC. Several provisions of Section 272 grant the Commission authority to issue rules establishing accounting safeguards so as to minimize the risk of anticompetitive cross-subsidization. See, e.g., Sections 272(b)(2), (c)(2), (f)(3).

The Commission tentatively concludes (at ¶ 64) that its existing affiliate transaction rules generally satisfy the statute's requirement that there be safeguards to prevent a BOC from using its regulated exchange operations to subsidize these separated operations.[6] In addition, the Commission recognizes (at ¶ 65) that the existing rules must be modified in certain respects in order to "provide more optimal protection against subsidization." As part of those modifications, the Commission proposes to adopt certain modifications to the affiliate transaction rules that it first proposed in 1993 in its Affiliate Transactions Notice.[7]

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6 See 47 C.F.R. § 32.27; see generally Joint Cost Order, 2 FCC Rcd. 1298.

7 See Amendment of Parts 32 and 64 of the Commission's Rules to Account for Transactions Between Carriers and Their Nonregulated Affiliates, Notice of Proposed Rulemaking, CC Docket No. 93-251, 8 FCC Rcd. 8071 (1993) ("Affiliate Transactions Notice").

AT&T generally supports these tentative conclusions. As the Commission notes (at ¶ 64), LECs have already implemented internal accounting systems that are designed to ensure compliance with the Commission's existing rules, and therefore the existing rules could be extended to these new separated operations with a minimum of disruption.

This section first addresses the proper scope of those rules. It then discusses the particular valuation methods the Commission should adopt, as well as needed modifications to the existing rules.

A. The Affiliate Transaction Rules Should Apply To All Services Provided By The BOCs Through A Separate Subsidiary.

First and most important, the Commission should clarify by rule that the affiliate transaction rules apply to all nonregulated activities conducted through a Section 272 or any other separate LEC subsidiary, regardless of whether the Act requires those activities to be conducted through a separate subsidiary. See NPRM, ¶¶ 66, 90. Any contrary rule would facilitate precisely the kind of anticompetitive cross-subsidization that Section 272 is designed to prevent. Indeed, a BOC could simply transfer its nonmandatory operations to its Section 272 separate subsidiary, or form additional subsidiaries, where it could then achieve through non-arm's length transactions exactly the sort of cross-subsidization that it could not have achieved directly through transactions involving Section 272's mandatory separated operations.[8]

Moreover, as AT&T explained in its BOC In-Region NPRM Comments (at 60-66), the Commission should apply dominant carrier regulation to the BOCs' in-region, interLATA services if authority to offer such services is granted. As dominant carriers, these BOC affiliates should be required to maintain regulated books in conformance with the Uniform System of Accounts (USOA), just as the BOCs do. See 47 C.F.R. Part 32. Thus, the affiliate must itself follow the affiliate transaction and cost allocation rules when dealing with nonregulated affiliates or when providing nonregulated services on an integrated basis. Moreover, application of the Part 32 rules to the BOCs' interLATA affiliates is necessary to facilitate audit of transactions between the BOC and the affiliate, given the threat of anticompetitive cross-subsidization.[9]

Nonetheless, the Commission should treat the affiliates' in-region, interLATA telecommunications services as "nonregulated" for purposes of accounting for transactions between the BOC and the affiliate, even if the telephone carrier

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8 To combat the possibility of similar cross-subsidization, the Commission should apply its new affiliate transaction rules to all incumbent LECs, not just the BOCs. See NPRM, ¶ 66.

9 Indeed, because of this threat of cross-subsidization and the difficulty of detection, the Commission should require the BOCs' interLATA affiliates to maintain books of account in conformance with USOA even if the Commission ultimately declares the affiliates nondominant, so as to permit the Commission and the States to monitor and audit their transactions more effectively.

operations of the affiliate are treated as "regulated" for all other purposes. See NPRM, ¶ 89. As the Commission notes, "BOC in-region interLATA telecommunications services . . . present a potential for improper subsidization," and therefore the provision of such services by a BOC affiliate must be subject to the full panoply of affiliate transaction rules designed to enforce the statute's requirement that all such transactions be conducted "on an arm's length basis" (see Section 272(b)(2)). Accordingly, the Commission has already correctly concluded that out-of-region interstate interLATA service provided by a BOC affiliate must be treated as "nonregulated."[10] If anything, the BOCs have even greater incentives to cross-subsidize the provision of in-region interLATA service, and therefore such services should also be treated as "nonregulated" for purposes of the affiliate transaction rules.

Furthermore, the Commission's rules should specify the accounting treatment of access services purchased by a BOC affiliate from that BOC. Section 272(e)(3) requires a BOC to charge its interLATA affiliate an amount for access "that is no less than the amount charged to any unaffiliated interexchange carriers." As AT&T explained in response to the BOC In-Region NPRM, at a minimum the BOC must charge its affiliate the tariffed rate for access. And the Commission must also scrutinize the BOC's tariffs to ensure that the tariffed rates are not

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10 Bell Operating Company Provision of Out-of-Region Interstate, Interexchange Services, Report and Order, CC Docket No. 96-21, FCC 96-288, ¶¶ 38-40 (released July 1, 1996) ("BOC Out-of-Region Order").

structured so as to give unique advantages to the BOC affiliate. See AT&T's BOC In-Region NPRM Comments at 39-40.

The Commission's rules, however, should also require the BOC's interLATA affiliate to reflect access charges in its end-user rates, at least for as long as the BOC retains its overwhelming dominance in the provision of exchange access services. While such rules cannot eradicate the threat of an anticompetitive price squeeze, the affiliate's imputation of access charges cannot be merely an accounting entry on that affiliate's books. The Commission should therefore establish price floors for interLATA services at a level at least equal to the BOC's access charges plus the incremental cost of the non-access portions of the service. This would prevent the most blatant forms of discriminatory pricing.

B. The Commission Should Adopt Its Existing Valuation Methods In This Context With Certain Modifications.

These measures standing alone, however, are not enough. The Commission should also (1) require all transactions between a BOC and its affiliates to be recorded in accordance with Part 32; (2) establish identical valuation methods for assets and services; (3) reject proposals to allow carriers to charge its affiliate a "prevailing price" adjusted for differing marketing costs; (4) adopt certain measures to verify estimates of fair market value; (5) require affiliates to obtain access services and local service resale only pursuant to tariff; (6) establish the prescribed interstate rate of return as the allowable rate of return for affiliate transactions; and (7) require annual audits.

Imposition of GAAP. Together, Sections 272(b)(2) and 272(c)(2) authorize the Commission to establish rules governing the accounting procedures the BOCs and their separate subsidiaries use. Section 272(b)(2) requires the affiliates to "maintain books, records, and accounts in the manner prescribed by the Commission" that are separate from the BOC's books, records, and accounts; and Section 272(c)(2) requires the BOCs to account for affiliate transactions "in accordance with accounting principles designated or approved by the Commission."

The Commission invites comment on whether the BOCs' separate subsidiaries should maintain books, records, and accounts in accordance with generally accepted accounting principles ("GAAP"). See NPRM, ¶¶ 68-69. Both the BOCs and their telephone carrier affiliates, as dominant carriers, must follow Part 32 USOA accounting procedures. Indeed, even if the Commission ultimately declares the BOCs' carrier affiliates to be nondominant (as it should not), the Commission should nonetheless require those affiliates to maintain books in conformance with USOA, to facilitate the auditing of transactions between the BOC and its carrier affiliates. Therefore, the Commission should permit only the BOCs' non-carrier affiliates to depart from the USOA and to follow only GAAP.

Arm's Length Transactions. Section 272(b)(5) requires that all "transactions" between the BOCs and their affiliates that offer interLATA telecommunications and information services must be "on an arm's length basis." The Commission proposes to implement this section by extending the existing rules concerning valuation methods to these transactions, along with some modifications that the Commission originally proposed in the Affiliate Transactions Notice. AT&T generally endorses this approach, although several aspects of the Commission's proposal deserve mention.

First, as AT&T explained in its Comments in the BOC In-Region NPRM,[11] the Commission should interpret the statutory term "transactions" broadly to include any transaction involving the transfer of money, personnel, resources or other assets, as well as any transaction involving requests by an affiliate to the BOC for exchange or exchange access services. Any less expansive interpretation would permit anticompetitive cross-subsidization, and public disclosure of all such transactions is essential to the Commission's efforts to monitor discrimination.[12]

Second, the Commission seeks comment on whether the affiliate transaction rules should require identical valuation methods for assets and services, as the Commission proposed in the Affiliate Transactions NPRM. See NPRM, ¶ 77. AT&T agrees

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[11] AT&T's BOC In-Region NPRM Comments at 27-29.

[12] The Commission also seeks comment on how to enforce the statutory requirement that all transactions be "reduced to writing and available for public inspection." See NPRM, ¶ 74. As AT&T explained in its BOC In-Region NPRM Comments (at 28-29), the Commission could implement this requirement in part by requiring tariffs for all services provided to affiliates and publicly available written contracts for all transfers of goods and other non-tariffed transfers. Internet access could be an efficient additional way of obtaining such information, but the Commission nonetheless should require the BOCs to file copies of the written documents with the Commission and make them available to the public.

that the Commission should amend the rules so that the asset valuation method applies to services as well. As the Commission notes (id.), valuing services at fully distributed cost (absent a tariff or prevailing company price) would reward a carrier for buying services at more than, and selling them for less than, fair market value. Moreover, if a carrier sells services to its affiliate for less than fair market value, it could cross-subsidize the affiliate's competitive operations in violation of Section 254(k). Thus, the Commission's rule with respect to assets -- requiring that carriers record the transaction at the higher of cost and fair market value when it is the seller, and the lower of cost and fair market value when it is the purchaser -- would more faithfully implement Section 272's requirement that such transactions be "on an arm's length basis."

Prevailing Company Prices. The Commission also seeks comment on whether the "prevailing company price" method (which currently applies as the first level test for the booking of transfers of nontariffed assets and services between affiliates) accurately reflects fair market value insofar as a carrier must spend additional amounts on "marketing efforts and transactional costs" to attract and keep non-affiliate customers. See NPRM ¶ 80. Whether or not carriers would spend differing amounts on such costs for affiliates and non-affiliates, the statute squarely forecloses any rule that would permit any adjustment to the "prevailing price" to reflect such differences. Section 272(b)(5) requires that affiliate transactions be conducted "on an arm's length basis" -- i.e., as if the two entities were in fact non-affiliated. Any other rule would give a BOC undue incentives to grant discounts to its affiliate based on alleged lower marketing costs, thereby lowering the affiliate's costs and facilitating cross-subsidization. Just as the BOC must charge its affiliates tariffed rates where applicable -- which would reflect any marketing costs incurred by the carrier -- so too must the BOC charge the true prevailing market price where there is no tariff.

The Commission should not adopt its alternative proposal to eliminate the prevailing company price method altogether. See NPRM, ¶¶ 81-82. Although the prevailing company price method, like all of the valuation methods, is flawed and subject to abuse, the fact that such prices are determined in a market does provide some external discipline on the BOCs' and their affiliates' pricing methods. Rather than eliminating the method altogether, the Commission should modify the rules so that the prevailing company price method is available only if the affiliate sells a substantial percentage, by quantity, of that product line to nonaffiliated customers. Compare Affiliate Transactions Notice, 8 FCC Rcd. at 8080 (¶ 22).

Fair Market Value. The Commission also seeks comment on its proposal to allow carriers to make good faith estimates of fair market value rather than to dictate by rule the methodology that should be used. See NPRM, ¶¶ 83-85. While AT&T does not object to such an approach for the transactions to which it would apply (see id. at ¶ 83), the Commission should establish criteria for such valuations along the lines suggested in paragraphs 84-85 of the NPRM. In addition, the Commission should require carriers to retain sufficient records to document whatever methodology they have used, in a form that would enable third parties to reproduce the analysis in the context of an audit or other investigation or proceeding. And these transaction prices must be publicly disclosed so that any nonaffiliated carrier can avail itself of the "fair market price."

Tariff-Based Valuation. The Commission's proposal to amend its rules to permit the substitution of rates for "interconnection and collocation services and network elements" contained in interconnection agreements for tariffed rates is unnecessary. See NPRM, ¶ 86. As AT&T explained in its Comments in the BOC In-Region NPRM (at 19-24), Section 272(b)(1)'s requirement that the BOCs' affiliates "operate independently" of the BOCs prohibits any integration of exchange and interexchange facilities, including the purchase of "interconnection and collocation services and network elements" (NPRM, ¶ 86). The BOCs' affiliates should be prohibited from offering any exchange services except through total service resale at tariffed rates. Similarly, the BOCs' affiliates should obtain all transmission capacity from the BOC only pursuant to tariff, as was the case under the Commission's Computer II rules.[13] With the adoption of

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[13] See AT&T's BOC In-Region NPRM Comments at 20-22; see also Amendment of Section 64.702 of the Commission's Rules and Regulations (Second Computer Inquiry), Final Decision, 77 F.C.C.2d 384, 474, 477-81 (1980) ("Computer II Final Decision"), recon., 84 F.C.C.2d 50 (1980), further recon., 88 F.C.C.2d 512 (1981), aff'd sub nom. Computer and Communications Industry Ass'n v. FCC, 693 F.2d 198 (D.C. (continued...)

these rules, there would be no need for the Commission's suggested amendments to the affiliate transaction rules.

Return Component. AT&T supports the Commission's proposal to require the BOCs to use the prescribed interstate rate of return as the uniform allowable rate of return for affiliate transactions. See NPRM, ¶¶ 87-88. Allowing a BOC to use a different rate of return would not only facilitate cross-subsidy, but would also lead to inefficiencies: it would give a BOC a powerful incentive to shift to the subsidiary functions that the BOC would otherwise perform itself, or vice versa.

Auditing. Finally, the Commission should require, on an annual basis, a Federal/State audit conducted by an independent auditor to ensure compliance with Section 272 and its implementing regulations. Although the Act requires that such an audit be performed at least every two years, nothing in the Act precludes the Commission from exercising its general authority over accounting matters to require audits annually. Annual audits are necessary because of the inherent difficulties of bringing accounting irregularities to light and acting to correct them in a timely manner. As the Commission has recognized, there can be delays of several years between the period covered by an audit and a order to show cause resulting from that audit.[14]

(...continued)
Cir. 1982), cert. denied, 461 U.S. 938 (1983).

[14] See, e.g., Southwestern Bell Telephone Company, Order to Show Cause, AAD 95-32 (released March 3, 1995) (order to show cause in 1995 concerning period 1989-92); Ameritech Telephone Operating Companies, AAD 93-146, Order to Show (continued...)

Moreover, to further facilitate such auditing, all BOC affiliates should be required to issue a separate set of financial reports, income statement, balance sheet, and statement of cash flows for public review on a quarterly basis.

III. THE COMMISSION SHOULD ESTABLISH RULES GOVERNING THE BOCS' PROVISION OF INTERLATA SERVICES ON AN INTEGRATED BASIS.

In addition to the measures described above, the Commission should establish clear rules governing the BOCs' provision of interLATA services on an integrated basis. Section 271(a)(2) permits a BOC to provide, upon enactment, interLATA telecommunications service originating out-of-region; and Section 271(a)(3) permits a BOC to provide "incidental" interLATA services upon enactment.[15] With respect to "incidental" services, Section 271(h) provides that the "Commission shall ensure that the provision of services authorized under [Section 271(g)] by a Bell operating company or its affiliate will not adversely affect telephone exchange service ratepayers or competition in any telecommunications market."

The Commission seeks comment on whether the existing cost allocation rules would be adequate to protect competition where a BOC chooses to provide these interLATA services on an integrated basis. See 47 C.F.R. §§ 32.23 & 64.901. AT&T

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14 (...continued) Cause (released March 3, 1995) (order to show cause in 1995 concerning period 1988-89).

15 "Incidental" interLATA services are listed in Section 271(g), and include, inter alia, alarm monitoring services and commercial mobile services.

supports the Commission's proposal (at ¶ 39) both to apply the cost allocation rules to such services and to treat such services as nonregulated for purposes of the accounting rules. While the cost allocation rules could not prevent harmful cross-subsidies, such rules would make it difficult for a BOC to engage in the most blatant forms of cross-subsidization.

Moreover, Section 272(e)(3) requires that the BOC "impute to itself (if using the access for its provision of its own services), an amount for access that is no less than the amount charged to any unaffiliated interexchange carriers for such service." To implement this requirement, the BOCs should be required to record the imputed exchange access charges as an expense, which would then be assigned to nonregulated activities with a credit to the regulated exchange access revenue account, as the Commission suggests in the NPRM (at ¶ 41). The access charge must be reflected in the end user's rates, however, and not merely as a book entry by the BOC. Therefore, to implement this requirement and to ensure compliance with the BOC's nondiscrimination obligations, the Commission should establish price floors at a level at least equal to the amount of the access charge plus the incremental cost of the non-access portions of the service. This would prevent the most egregious forms of cross-subsidization.

CONCLUSION

For the reasons stated, the Commission should implement its proposed accounting safeguards, modified and expanded as suggested above.

Respectfully submitted,

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